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JUL 17 1962

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IN THE

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1962

No. 282

UNITED STATES OF AMERICA,
Petitioner,

vs.

MACLIN P. DAVIS and EDITH U. DAVIS,
Respondents.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SIXTH CIRCUIT

BRIEF FOR THE RESPONDENTS IN OPPOSITION

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INDEX

Opinion Below 1
Statement 2
Reasons This Cause Should Not Be Reviewed 2
Conclusion 6

Cases Cited

Ballenger v. *United States*, 301 F. 2d 192 ..... 2, 3
Commissioner v. *Berenbaum*, 369 F. 2d 337 ..... 2, 3
Estate of Henry A. Golwynne, 26 T. C. 1209 3
Humphrey's Executor v. *United States*, 295 U. S. 602, 626 5
Keefe v. *Cote*, 213 F. 2d 651 (1 Cir.) 3
Levin v. *Commissioner*, 385 F. 2d 521, 526 4
Perry S. Lewis, 47 T. C. 129 3
Arthur D. McDonald, 52 T. C. ..... No. 8 4
Joe L. Smith, Jr., 49 T. C. 476 3

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OPINION BELOW

The opinion of the Court of Appeals is reported at 408 F. 2d 1139 (1969).

STATEMENT

The Statement of the petitioner omits the significant facts (1) that the Tennessee Foundry & Machine Company had always intended to redeem the preferred stock when the RFC loan was paid off, and (2) that the redemption was simply the final step taken in completion of the original purpose to provide temporary working capital while the RFC loan was in effect, but no longer.[1]

REASONS THIS CAUSE SHOULD NOT BE REVIEWED

1. The decision below is not in conflict with a decision of another Court of Appeals on the same matter. The petition states that the Fourth Circuit's decision in *Ballenger* v. *United States*, 301 F. 2d 192, and the Tenth Circuit's decision in *Commissioner* v. *Berenbaum*, 369 F. 2d 337, "hold that the business purpose for the issuance of preferred stock is not material in determining whether the later redemption is essentially equivalent to a dividend." In *Ballenger*, however, the Court expressly held that there was "no legitimate business purpose" for the redemption (301 F. 2d 199); and in *Berenbaum* the Court emphasized the failure of the taxpayer to "come forward with additional evidence on the question" [of business purpose] after the basic facts had been stipulated and the issue had been placed in controversy by the pleadings. (369 F. 2d 341). In each of these cases, moreover, the distribution was substantially pro rata without applying the attribution rules.

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1. The District Court and the Court of Appeals both relied strongly on these facts. 274 F. Supp. 466, 471; 408 F. 2d 1139, 1143-4.

In *Ballenger* the taxpayer husband owned all the common stock except one share in the name of his wife, which the Court said was "too small to upset the pro rata characterization of the distribution." (301 F. 2d 199). With respect to the taxpayer in *Berenbaum*, "there was no reduction in his control, and only an insignificant reduction in ownership represented by the redeemed shares." (369 F. 2d 341). There is no decided case in which a redemption has been held to be essentially equivalent to a dividend, solely because of application of the attribution rules, where a genuine business purpose existed, as in the instant case. Cf. *Perry S. Lewis*, 47 T. C. 129.

2. In this case, as in *Keefe* v. *Cote*, 213 F. 2d 651 (1 Cir.), there was a two-pronged transaction. The stockholder there obtained his stock as consideration for assuming a corporate indebtedness. When the corporation was in better financial shape, it redeemed the stock, restoring the status quo. In neither that case nor the instant case can the purpose of the redemption fairly be insulated from the purpose of the issuance. Here, moreover, there was a clearly identifiable date as of which the preferred stock was to be redeemed—the date of payment in full of the RFC debt. In this respect the preferred stock was like a subordinated debt. The Tax Court has consistently followed *Keefe* v. *Cote*, where there were similar two-pronged transactions, e.g., *Estate of Henry A. Golwynne*, 26 T. C. 1209, and *Joe L. Smith, Jr.*, 49 T. C. 476. The Fourth Circuit's inability, in *Ballenger*, to "understand how a valid reason for the issuance of preferred stock can, once its purposes have been served, be converted into a reason for its redemption," comes from the manner in which the proposition is phrased. There is no "converting" of one reason into another. The two "reasons" are opposite sides of the same coin.

3. The deficiency was determined in the instant case only because the taxpayer, Mr. Davis, bought Mr. Bradley's common stock and gave it to his children in 1952, during the interval between the issuance of the preferred stock in 1946 and its redemption in 1963. The Internal Revenue Service, on the theory that the attribution rules thereby became applicable, determined that he was the sole stockholder and that the redemption of his preferred stock was accordingly pro rata. The District Court and the Court of Appeals both held that this acquisition of the Bradley stock, followed by the gifts to his children, did not impair the legitimacy of the purpose underlying the issuance of the preferred stock or alter the fact that redemption was simply the final step taken in contemplation of the original purpose for which the preferred stock was issued. There is no decided case which takes a contrary position under similar facts. If business purpose is to be ignored, the attribution rules should not be applied, and the result will be the same. The Second Circuit, which held the attribution rules to be generally applicable under Section 302(b)(1), has recognized that there are situations in which the application of such rules would be "unwise" (*Levin* v. *Commissioner*, 385 F. 2d 521, 526); and if judge-made exceptions to applicability are allowable, the rules are simply not applicable as *rules*, but only as guides.

4. The legislative history of Section 302(b)(1) demonstrates that Congress in 1954 intended to perpetuate the existing tests under Section 115(g) of the 1939 Code as to whether a redemption is essentially equivalent to a dividend. A recent case pointing this out is *Arthur D. McDonald*, 52 T. C. ..... No. 8, filed April 16, 1969, where a redemption of preferred stock was held not to be essentially equivalent to a dividend because it resulted in a substantial change in the taxpayer's interest in the corporation. Such is admittedly the case here unless fiction is

substituted for fact by an unwarranted application of attribution rules which (if effect is to be given both to the basic Congressional intent and the literal statutory language) are made applicable only to paragraphs (2) and (3) of Section 302(b), where ownership of stock is specifically referred to.

5. The true basis for the requested review of this case seems to be the hope of obtaining from this Court a "unitary resolution" (p. 10) of "confusion in this area of tax law." (p. 4). This aim rests on the false assumption that a decision by this Court of this case could properly have a prospective effect on the decision of other cases involving the same statutory provision but essentially different facts. There is no suggestion in the petition that there is any pending case involving similar facts, although it is stated that there are some thirty-five cases pending in the courts which involve the application of Section 302(b)(1), and that in fifteen of these cases, the "business purpose" question has been raised (footnote 6). Perhaps an opinion of this Court in this case would include expressions "beyond the point involved" (*Humphrey's Executor* v. *United States*, 295 U. S. 602, 626), but such expressions do not come within the rule of *stare decisis* and would not have the quasi-legislative effect envisioned by the authors of the petition. It is the function of Congress, and not of this Court, to clarify the confusion referred to in the petition.

6. Where the decision has been for the government (or the Commissioner of Internal Revenue) in a tax case, but no clear-cut conflict between circuits in cases involving similar facts, the Solicitor General has consistently and successfully opposed the granting of certiorari, no matter how confusing the area or how clearly erroneous the decision below. A different rule for review should not be followed where the taxpayer happened to be successful below.

Moreover, in this case the decision below was clearly correct.

7. The opinion of the District Court was not annexed to the petition as required by paragraph 1 (i) of Rule 23.

CONCLUSION

The petition for a writ of certiorari should be denied.

Respectfully submitted,

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